

## Internal Revenue Service

Number: **200840009**

Release Date: 10/3/2008

Index Number: 1362.00-00, 1362.01-00,  
1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B1

PLR-105091-08

Date: June 19, 2008

### Legend:

X =

Y =

Z =

A =

B =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

\$m =

\$n =

Dear :

This letter responds to your letter dated January 30, 2008, requesting relief under §§ 1362(b)(5) and 1362(f) of the Internal Revenue Code.

Facts:

You have represented that the facts are as follows. X made a timely election to be taxed as an S corporation for federal tax purposes effective Date 1. However, at the time of the initial election, X did not qualify as an S corporation. Subsequently, X took corrective action to qualify as an S corporation by incorporating under State law on Date 2.

Until Date 3, A was the sole shareholder of X. On Date 3, B became the second shareholder of X. X intended to issue new shares to both A and B, but instead issued the shares to Y and Z, State S corporations. Y is wholly owned by A, and Z is wholly owned by B. Although the shares of X were held by Y and Z, X represents that at all times it has acted and filed consistently with its belief that it was an S corporation. Specifically, A reported Y's share of income on A's federal income tax return, and B reported Z's share of income on B's federal income tax return, except in Year 1, when due to an inadvertent error B underreported Z's share of income by \$m. X and its shareholders agree to make any adjustments, consistent with the treatment of X as an S corporation, which the Secretary may require.

Law and Analysis:

Section 1362(a) provides that a small business corporation may elect to be an S Corporation.

Section 1362(b) provides the rule on when an S election will be effective. Section 1362(b)(2) provides in relevant part that if an S election is made within the first two and one-half months of a corporation's taxable year, then the corporation will be treated as an S Corporation for the year in which the election is made. Under § 1362(b)(3), however, if an S election is made after the first two and one-half months of a corporation's taxable year, then that corporation will not be treated as an S corporation until the taxable year after the year in which the S election is filed.

Section 1362(b)(5) provides that if: (1) no § 1362(a) election is made for any taxable year, and (2) the Secretary determines that there was reasonable cause for the failure to timely make such election, then the Secretary may treat such an election as timely made for such taxable year and § 1362(b)(3) shall not apply.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a "small business corporation" for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that an S corporation cannot have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides in relevant part that if: (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion:

Based solely on the facts submitted and the representations made, and provided that X otherwise qualifies as an S corporation, we conclude that X will be treated as an S corporation effective Date 2. Within 60 days from the date of this letter X should submit a properly completed Form 2553 effective Date 2, with a copy of this letter attached, to the relevant service center.

Additionally, we conclude that X's S election terminated on Date 3 when Y and Z, both ineligible shareholders, acquired X stock. We also conclude that the termination of X's S election constituted an inadvertent termination within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X's subchapter S election has not otherwise terminated under § 1362(d). This ruling is conditioned on B sending a payment of \$n with a copy of this letter to the following address: Internal Revenue

Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Terri Lackey, Manual Deposit. This payment must be sent no later than Date 4. If this condition is not met, then this ruling is null and void. Furthermore, if this condition is not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the above-described facts under any other provision of the Code. In particular, no opinion is expressed or implied concerning whether X's S election was otherwise valid under § 1362.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

*David R. Haglund*

David R. Haglund  
Senior Technician Reviewer, Branch 1  
Office of Associate Chief Counsel  
Passthroughs & Special Industries

Enclosures (2)  
Copy of this letter  
Copy for ' 6110 purposes